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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of Excess PacifiCorp Income Tax Cost Monies Collected in Rates	**REQUEST FOR AGENCY ACTION** DOCKET NO. 05-035-___

Pursuant to Utah Code §§54-7-9 and 54-10-4, the Utah Committee of Consumer Services ("Committee"), in its name and on behalf of residential utility consumers and utility consumers engaged in small commercial enterprises in the State of Utah, requests that the Public Service Commission of Utah ("Commission") act as hereinafter set forth.

STATEMENT OF REQUEST

1. The Committee requests that the Commission order PacifiCorp ("PacifiCorp" or "Utility") to return to Utah ratepayers the monies which PacifiCorp since its 1999 merger collected in Utah rates to: (i) pay purported income tax costs which the Utility knew were in excess of any lawful income tax liability; and/or (ii) subsidize or pay costs of the 1999 merger in contravention of the Commission's order that approved the merger on the condition that neither merger costs nor the acquisition premium would not be recoverable in rates.

2. Subsequent investigation and discovery in these proceedings may show that other or

additional relief is appropriate or warranted. The Committee reserves the right to request such other or additional relief at such time in this proceeding in order that the electric service PacifiCorp provides to Utah ratepayers "will be in all respects adequate, efficient, just and reasonable."[1]

3. The Committee is a Utah state governmental agency having the statutory responsibility, pursuant to Utah Code § 54-10-4, to represent, and advocate on behalf of, the interests of residential consumers and those engaged in small commercial enterprises in the state of Utah with respect to utility rates and other utility regulatory matters.

4. PacifiCorp is a public utility monopoly incorporated in the State of Oregon and doing business in the State of Utah subject to the regulatory authority of the Commission as stated in Utah Code§54-4-1. The Utility is a wholly-owned subsidiary of PacifiCorp Holdings, Incorporated ("PHI"), a State of Delaware incorporated second-tier holding company wholly owned by ScottishPower plc ("ScottishPower"),[2] a Scotland-headquartered energy supply company.

5. PHI and its USA subsidiaries, including PacifiCorp, are a holding company system ("PHI Group") regulated at all times in question by the U.S. Securities and Exchange

[1]Utah Code §54-3-1.

[2]When ScottishPower first structured its USA holdings after acquiring PacifiCorp, it interposed a further holding company layer between itself and PHI, NA General Partnership ("NAGP"). However, "PHI and NAGP merged on December 31, 2003, with PHI as the surviving entity." [SEC audit Finding 14 (P-IER 39)].

Commission ("SEC") pursuant to the Public Utilities Holding Company Act of 1935 ("PUHCA") and SEC Rules promulgated thereunder ("SEC Rules").

Factual Background

6. A 2003-2004 SEC investigative audit ("SEC Audit") of ScottishPower's USA holdings determined that PacifiCorp unlawfully provided to PHI, and PHI unlawfully appropriated, in fiscal tax years 2000, 2001, 2002 and 2003, at least $225.7 million which, according to federal regulatory law as well as contractual agreement of the parties is, and must be, Utility property.[3]

[3]SEC Audit Finding 14 (P-IER 39).

7. The monies in question are the Utility's lawfully apportioned share of consolidated income tax cost savings achieved by PHI, PacifiCorp and other PHI subsidiaries in the PHI Group as a result of their having filed a consolidated income tax return for each of those fiscal tax years. A consolidated income tax return nets affiliate group members' losses against affiliate group members' gains, and can substantially lower the tax liability of the consolidated group from what it would have been had each member filed and paid its income taxes on an individual basis. Because PHI Group subsidiaries pre-pay to PHI their share of the group's consolidated income tax liability under a formula that assumes each is a separate taxpayer with separate taxpayer liability,[4] the apportionment of the group's annual consolidated income tax savings results in the allocation or re-distribution of actual monies – the difference between the members' earlier prepayments for that tax year and the group's actual consolidated income tax liability to the various governmental taxing jurisdictions.

8. The SEC Audit found that applicable SEC Rules and the governing contractual tax agreement[5] between PHI, PacifiCorp and other members of the PHI Group ("tax agreement"),

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[4]The PHI group's contractual agreement with respect to filing and paying income taxes provides:

> "Each subsidiary shall pay to PHI the amount of tax resulting from t he items of taxable income, gain or loss, deductions, credits, and other special items generated and solely attributable to that particular subsidiary as if that subsidiary was a separate taxpayer filing its own consolidated or combined return directly with the taxing authority, be it federal, state or local." ["NA General Partnership, PacifiCorp Holdings, Inc. and Subsidiaries Income Tax Allocation Policy Dated April 2000," pp. 2-3.]

[5]SEC Rules implementing PUHCA restrict and regulate financial transactions between a regulated holding company and its subsidiaries. SEC Rule 250.45(a) requires prior notice to the SEC of any such transaction; however, SEC Rule 250.45(c) waives the Rule 45(a) requirement

apportion consolidated income tax savings to *profitable members* of the group, and exclude *unprofitable group members* from any apportionment at all.[6]

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in the case of a regulated holding company system's consolidated income tax filing "if such consolidated tax return is filed pursuant to a tax agreement, in writing" meeting several further SEC Rule conditions. The PHI Group executed such a tax agreement, the April 1, 2000, NA General Partnership, PacifiCorp Holdings, Inc and Subsidiaries Income Tax Allocation Policy, which is the "tax agreement" reviewed and referred to in the SEC Audit's findings regarding PHI's wrongful appropriation of subsidiary monies.

[6]SEC Rule 250.45(c)(2) requires:

> [t]he consolidated tax shall be apportioned among the several members of the group in proportion to (i) the corporate taxable in come of each such member, or (ii) the separate return tax of each such member. . .

The PHI group tax agreement provides:

> No subsidiary shall be entitled to any payment from PHI or any other subsidiary for net operating loss or other deductions, credits

or tax benefits generated by such subsidiary that cannot be used to reduce the tax liability of that subsidiary for the current taxable year on a separate return basis even if those benefits are utilized by the NAGP Group against income or tax of the NAGP Group.

9. Findings and parties' positions made or recounted in a September 28, 2005, order of the Public Utility Commission of Oregon make clear that the PHI group's consolidated income tax savings since the 1999 PacifiCorp/ScottishPower merger largely result from a $160.31 million annual interest expense:

> that PHI pays to ScottishPower [that] is deductible on PHI's consolidated income tax returns (filed on behalf of PacifiCorp and other PHI affiliates). The effect of this deduction is to eliminate or substantially reduce the consolidated group's taxable income, resulting in PacifiCorp collecting more money from ratepayers than the consolidated group pays in taxes to governmental units.[7]

10. The SEC found illegal PHI appropriation of subsidiaries' monies for each of the tax years in question as follows:

> Period ended March 31, 2000 had consolidated taxable income of
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> $149.9 million resulting in a tax liability of $34.6 million. The
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> only group of companies with a loss was PacifiCorp Financial

[7]Order No. 05-1050. The Oregon Commission order determined what PacifiCorp's prospective Oregon rates should be. It did not address the SEC findings or the propriety of excess monies collected in prior rates for income tax costs. Giving effect to a recent Oregon law providing that "[u]tility rates that include amounts for taxes should reflect the taxes that are paid to units of government to be considered fair, just and reasonable," the Oregon commission reduced PacifiCorp's income tax expense in rates going forward by allocating to the utility that portion of the consolidated income tax savings created by PHI's "interest expense deduction" equivalent to the ratio PacifiCorp's "gross profits" bear to the gross profits of the PHI group. [Pp.13-19 of the order.]

Services ("PFS") and Subsidiaries. Its tax benefit was $13.8 million. This amount should have been allocated to profitable companies based on either taxable income or separate return tax liability.

Period ended March 31, 2001 had consolidated tax losses of $48.8 million. . . . Within the group, NA General Partnership and PFS [PacifiCorp Financial Services] had tax benefits of $116.4 million and $5.3 million respectively. There were five profitable subsidiaries that paid up $109.6 million to PHI. Under proper application of Rule 45(c)(2), these profitable companies would have paid zero to PHI even with the group having a consolidated NOL.[8]

Period ended March 31, 2002 had consolidated tax losses of $171.6 million. The following companies paid their separate return tax liabilities to PHI: PacifiCorp Group Holdings - $60.6 million; Pacific Capital Harbor - $23.11 million; Pacific Minerals - $5.9 million. Under proper application of Rule 45(c)(2), these profitable companies would have paid zero to PHI even with the group having a consolidated NOL.

Period ended March 31, 2003 had consolidated taxable income of $31 million. NA General Partnership was able to utilize its NOL carry forward to offset this liability on a consolidated basis. The following companies paid their separate return tax liabilities to PHI: PacifiCorp - $74.5 million; PHS - $38.7 million; PHI - $1.9 million. Under proper application of Rule 45(c)(2), these profitable companies would have paid zero to PHI even with the group having utilized a consolidated NOL.

[8] "NOL" is an accounting or income tax term meaning "net operating loss" for the tax year.

In summary, the Examination Staff believes that cash should be reallocated in the amounts designated below to the appropriate companies for the following years:

2000 – $13.8 million
2001 – 109.6 million
2002 – 89.6 million
2003 – 115.1 million

Total – $328.1 million.[9]

[9]SEC Examination Staff Finding 14 (P-IER 39), Examination Response Dated June 22, 2004.

11. The SEC directed that the misappropriated monies be re-allocated back to the subsidiary companies.[10] However, in the case of the $225.7 million of PacifiCorp monies, the SEC audit allowed PHI to credit against those funds a $150 million cash capital contribution ScottishPower made to PacifiCorp "following losses incurred by PacifiCorp as a result of the breakdown of Hunter Power Station in November 2000 and the excess power costs incurred during 2000 to 2002 at the time of the West coast power crisis."[11] The SEC Audit did not mention the separate and significant rate recovery PacifiCorp received in Utah for those extraordinary power costs,[12] nor did it discuss what the Utility's need for a large capital infusion in 2002 might have been had the wrongful transfer and appropriation of $225.7 million not occurred.

12. In addition to its findings and disposition regarding PHI's wrongful appropriation of subsidiaries' monies in prior years, the SEC Audit required that PHI provide credible evidence that consolidated tax benefit monies of the PHI Group for fiscal tax year 2004 were properly

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[10]SEC Audit Finding 14 (P-IER 39). The SEC states:

> PHI is to provide revised tax worksheets and support entries for the fiscal years ended March 31, 2000, 2001, 2002 and 2003 and provide evidence to the Examination Staff by May 14, 2004 that cash has properly passed to the corporate participants that should have received it under the proper application of Rule 45(c).

[11]SEC Audit Finding 2 (S/P-IER 17), III.

[12]PacifiCorp recovered in excess of $90 million from Utah ratepayers for extraordinary power costs incurred as a result of the November 24, 2000 to May 8, 2001 Hunter power plant breakdown and for excess power costs incurred from May 9, 2001 through Sept 30, 2001. [Testimony of D. Douglas Larson, Vice President of Regulation for PacifiCorp, pp. 26-27; and Testimony of Dan Gimble, Energy Group Mgr., Utah Committee of Consumer Services, pp. 126-127; as reported in.Reporter's April 17, 2002, Transcript of Proceedings, Docket Nos. 01-035-23, 01-035-29, and 01-035-36

allocated to PacifiCorp and other group subsidiaries in accordance with SEC Rules and the PHI Group tax agreement.[13]

[13] *Id.*

13. During the course of the SEC Audit, ScottishPower petitioned the SEC to grant an exception to SEC Rule 45(c) that bars "the parent company of a registered holding company system [from retaining] the tax benefit associated with its tax loss"[14] to enable PHI to lawfully retain from the Group's consolidated income tax savings benefits "the cash benefits associated with the tax benefits related to the acquisition indebtedness that ScottishPower incurred in acquiring PacifiCorp."[15]

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[14]SEC Audit Finding 13 (P-IER 38).

[15]SEC Audit Finding 13 (P-IER 38). The SEC Audit stated:

> Rule 45(c) does not permit the parent company of a registered holding company system to retain the tax benefit associated with its tax loss. In its proposed amendment to Rule 45(b)(6), the Commission stated "the corporate relationships required by the Act assure that the deductible corporate expenses of the holding company itself will always create a consolidated tax saving, since Section 13(a) of the [Public Utilities Holding Company] Act [of 1935] precludes such expenses being passed on to the subsidiaries,

14. The SEC audit acceded to ScottishPower's request on the condition PHI amend the PHI Group tax agreement to include, among others, the following provisions:

> (4) Clearly state that the Parent Company will pay its own tax liability and any losses will be allocated to profitable members of the group. In addition, no subsidiary will pay more than its separate return tax liability.

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through service charge or contract, so as to transform them into corporate deductions of the subsidiaries. In light of the legislative history referred to, an expense reimbursement of the holding company, in the guise of a tax allocation, would seem inconsistent with Section 13(a)." Any request for PHI to retain its tax benefits should be limited to costs associated with acquisition debt and not operating expenses.

(5) Include language for PHI to retain only the tax benefits associated with the acquisition indebtedness ScottishPower incurred to acquire PacifiCorp. All other tax benefits will be allocated to profitable subsidiaries based on the method described in (2) above.[16]

15. A new PHI Group tax agreement, dated April 1, 2004, containing the above provisions was subsequently approved by the SEC with the added requirement that the agreement state PHI"s retention of its tax benefit associated with acquisition indebtedness is prospective only.[17]

Cause of Action

16. PacifiCorp, since its 1999 merger with ScottishPower has knowingly and unlawfully collected monies in Utah rates to pay purported income tax costs in excess of any lawful income tax liability. Utah utility regulatory law requires that all such monies be returned to Utah ratepayers.

[16]Id.

[17]SEC Audit Finding 13 (P-IER 38).

17. $225.7 million. The SEC Audit conclusively determined that PacifiCorp wrongfully and illegally transferred to PHI, and PHI wrongfully appropriated, at least $225.7 million of PacifiCorp monies during the time period from ScottishPower's 1999 acquisition of the Utility through March 31, 2003, the conclusion of PHI's fiscal tax year 2003. A proper accounting of those monies during that same time period by PacifiCorp and PHI would have reduced the Utility's income tax costs in Utah rates. The rates that included those excess tax cost monies were, therefore, necessarily unjust, unreasonable and unlawful under Utah law;[18] and the excess tax cost monies consequently need to be returned to Utah ratepayers from whom they were wrongfully taken.

18. Utah's jurisdictional share of the $150 million PHI capital contribution the SEC Audit allowed PHI to credit against the $225.7 million to be returned to PacifiCorp is more than offset by rate recovery PacifiCorp obtained from Utah ratepayers for the extraordinary costs or losses the $150 million capital infusion addressed; namely, losses associated with the Hunter

[18]Utah Code §54-3-1 provides:

> All charges made, demanded or received by any public utility, . . . shall be just and reasonable. Every unjust or unreasonable charge made, demanded or received. . . is hereby prohibited and declared unlawful.

plant breakdown and the 2000 to 2002 west coast power crisis.[19] Therefore, any credit of the $150 million PHI capital contribution against Utah's jurisdictional share of the $225.7 misappropriated Utility monies is unwarranted and would constitute double charging Utah ratepayers for the same costs or losses.

19. Excess Tax Monies Collected from Utah Ratepayers in Fiscal Tax Year 2004. As mentioned in Paragraph 12 above, the SEC audit, in addition to directing the re-allocation of subsidiaries' monies which PHI wrongly appropriated in fiscal tax years 2003 and earlier, required that PHI submit credible evidence to show the PHI Group's consolidated income tax benefits for fiscal tax year 2004 were properly allocated to PacifiCorp and other subsidiaries. Had PacifiCorp and PHI properly accounted for allocated consolidated tax benefit monies in prior years Utah rates would have been adjusted prior to 2004 to eliminate the taking of rate money for tax costs that are never incurred. Because that did not happen as a result of the Utility's unlawful actions and failure to properly account for its consolidated income tax savings, fiscal 2004 Utah rates were necessarily unjust, unreasonable and unlawful under Utah law; and the excess income tax cost monies in them that made them unjust and unreasonable must be returned to Utah ratepayers.

20. Excess Tax Monies Collected from Utah Ratepayers After Fiscal Tax Year 2004. The existence of excess Utility income tax cost monies accruing in prior tax years as a result of PacifiCorp's and PHI's improper accounting for the group's consolidated income tax savings leads to the reasonable conclusion such excess monies will arise as a result of the PHI group's

[19]See footnote No. 11, above.

fiscal tax year 2005 consolidated income tax filings, as well. The amount of any such fiscal tax year 2005 monies must be determined and returned to Utah ratepayers for the same reasons given above.

21. Excess Monies Collected in Utah Rates to Subsidize or Pay PacifiCorp Acquisition Costs. The findings and recounting of parties' positions in the recently-concluded Oregon PacifiCorp general rate case,[20] as well as the findings of the SEC Audit, make reasonably clear that, at least with respect to fiscal tax year 2005 and probably with respect to earlier fiscal tax years as well, PacifiCorp paid or transferred to PHI rate-derived monies to pay or subsidize ScottishPower's PacifiCorp acquisition costs. To the extent that happened, it violated the condition the Utah Commission placed upon its approval of the1999 ScottishPower/PacifiCorp merger that "merger-related transaction costs nor the acquisition premium will be recovered in rates."[21]

22. The wording of the Commission's order makes clear that the ban against any merger transaction costs finding their way into rates is complete:

> [i]n our review of the record on transaction costs and of the Stipulation conditions which pertain to them, we find no mention of the possibility that some costs may not yet have been identified. Applicants believe the list in Stipulation Attachment 2 is complete. The Division and the Committee have no independent opinion. Common sense suggests that costs other than those in Attachment 2 may exist. For instance, we note that the time spent pursuing the merger by senior officials of PacifiCorp is not listed

[20]Oregon Public Utility Commission Order No. 05-1050. See Paragraph 8, above.

[21]November 23, 1999 Report and Order, Docket No. 98-2035-04, pp. 22-25.

> as a transaction cost. Competent audit may reveal other examples as well.
>
> To assure us that no transaction cost is recovered in rates, the Division testifies that it will perform an audit and act upon its results in a general rate case. We will rely on this. Such an audit is necessary to ensure that all transaction costs, including any not identified by the Applicants, are accounted for below-the-line.[22]

23. The obvious intent of the Commission's carefully-worded language is to keep ScottishPower's cost in acquiring PacifiCorp payable from owner or shareholder funds only, and is further magnified by the fact that the rate recovery ban applies not only to the transaction cost but to the acquisition premium, as well, which was a major component of that cost.[23] The Commission would be penny wise and pound foolish to prohibit PHI from recovering "costs of time spent pursuing the merger by senior officials of PacifiCorp" (see Commission's quote, above), but then allow Utah rates to subsidize the acquisition indebtedness itself. Had Utah ratepayers understood they were going to help pay for the acquisition of PacifiCorp, they would have rightfully demanded an ownership interest in the purchase.

24. To the extent that Utah rate-derived monies went to subsidize or pay ScottishPower's

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[22] *Id.*, at 24-25.

[23] "The Division quantified the value of the acquisition premium to be approximately $1.6 billion on the day the merger was announced, December 7, 1998." [November 23, 1999 Report and Order of the Commission, Docket No. 98-2035–04, p.23.]

PacifiCorp acquisition indebtedness costs, such use not only violates the Commission's conditional merger approval order but is contrary to basic principles of utility regulation, as well. Any such monies were clearly wrongfully collected in rates from Utah ratepayers and need to be returned to them.

25. The unforeseen and extraordinary action of the SEC Audit in identifying and returning the misappropriated monies in question to PacifiCorp, as well as PacifiCorp's unlawful taking of those monies from Utah ratepayers and PHI's unlawful appropriation of same, constitute established exceptions under Utah law to any claim that such a return is barred by the rule against retroactive ratemaking.

26. Because the rate monies in question are now not needed to pay legitimate Utility operating costs, absent intervention by this Commission, such monies will almost certainly end up (or end up again) in the owner's pocket. Any such ultimate outcome, in light of the unlawful and unjust taking and handling of those monies, would be fundamentally unjust and unfair to Utah ratepayers.

Further Possible Action or Relief

27. As stated in Paragraph 2, above, subsequent investigation and discovery in these proceedings may show that other or additional relief is warranted. The Committee accordingly reserves the right to amend and supplement this Request for Agency Action at such time to ask for such further or other relief.

PRAYER FOR RELIEF

The Committee respectfully requests the Commission to grant this petition and implement an appropriate remedy by means of a refund, establishing a regulatory liability

account or other mechanism providing effective relief consistent with the regulatory laws and rules of the State of Utah.

NOTICE TO INTERESTED PARTIES

In accordance with Utah Code §63-46b-3(3), a copy of this Request for Agency Action is being sent by regular mail and by email to the following parties at the following addresses:

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Respectfully submitted this 6th day of October, 2005.

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